

**DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**

[Docket No. FR-4401-N-05]

**Statutorily Mandated Designation of Difficult Development Areas and Qualified Census Tracts for Section 42 of the Internal Revenue Code of 1986**

**AGENCY:** Office of the Secretary, HUD.

**ACTION:** Notice.

**SUMMARY:** This document designates “Difficult Development Areas” and “Qualified Census Tracts” for purposes of the Low-Income Housing Tax Credit (“LIHTC”) under section 42 of the Internal Revenue Code of 1986 (“the Code”). The United States Department of Housing and Urban Development (“HUD”) makes new Difficult Development Area designations annually and makes Qualified Census Tract Designations at this time due to changes in section 42 of the Code enacted in the Community Renewal Tax Relief Act of 2000 (“CRTRA”).

**FOR FURTHER INFORMATION CONTACT:** For questions on how areas are designated and on geographic definitions: Steven Ehrlich, Economist, Division of Economic Development and Public Finance, Office of Policy Development and Research, Department of Housing and Urban Development, 451 Seventh Street, S.W., Washington, D.C. 20410, telephone (202) 708-0426, e-mail

**Steven\_R\_Ehrlich@hud.gov.** For specific legal questions pertaining to section 42 and this notice: Harold J. Gross, Senior Tax Attorney, Office of the General Counsel, Department of Housing and Urban Development, 451 Seventh Street, S.W., Washington, D.C. 20410, telephone (202) 708-3260, e-mail

**JERRY\_GROSS@hud.gov.** For questions about the "HUBZones" program: Michael P. McHale, Assistant Administrator for Procurement Policy, Office of Government Contracting, Suite 8800, Small Business Administration, 409 Third Street, S.W., Washington, D.C. 20416, telephone (202) 205-6731, fax (202) 205-7324, e-mail **michael.mchale@sba.gov.** A text telephone is available for persons with hearing or speech impairments at (202) 708-9300. (These are not toll-free telephone numbers.)

Additional copies of this notice are available through HUD User at (800) 245-2691 for a small fee to cover duplication and mailing costs.

**COPIES AVAILABLE ELECTRONICALLY:** This notice and additional information about Difficult Development Areas and Qualified Census Tracts are available electronically on the Internet (World Wide Web) at <http://www.huduser.org/datasets/qct.html>.

## **SUPPLEMENTARY INFORMATION:**

### **This Document**

The designations of Difficult Development Areas in this Notice are based on FY 2001 Fair Market Rents (“FMRs”), FY 2001 income limits and 2000 Census population counts as explained below. The designations of Qualified Census Tracts in this notice are based on 1990 Census data.

### **2000 Census**

Data from the 2000 Census on total population of metropolitan areas and nonmetropolitan counties are used in the designation of Difficult Development Areas. Data from the 2000 Census necessary to make Qualified Census Tract designations have not been released in their entirety by the Census Bureau. It is anticipated that all of the 2000 Census data necessary to make Qualified Census Tract designations will be released in time to publish new designations in September 2002 for effect in 2003.

### **Background**

The U.S. Treasury Department and the Internal Revenue Service thereof are authorized to interpret and enforce the provisions of the Internal Revenue Code of 1986 (the “Code”), including the Low-Income Housing Tax Credit (“LIHTC”) found at section 42 of the Code (26 U.S.C. 42) as amended. The Secretary of HUD is required to designate Difficult Development Areas and Qualified Census Tracts by section 42(d)(5)(C) of the Code.

In order to assist in understanding HUD’s mandated designation of Difficult Development Areas and Qualified Census Tracts for use in administering section 42 of the Code, a summary of section 42 is provided. The following summary does not purport to bind the Treasury or the IRS in any way, nor does

it purport to bind HUD, as HUD has no authority to interpret or administer the Code, except in those instances where it has a specific delegation.

### **Summary of Low Income Housing Tax Credit**

The LIHTC is a tax incentive intended to increase the availability of low-income housing. Section 42 provides an income tax credit to owners of newly constructed or substantially rehabilitated low-income rental housing projects. The dollar amount of the LIHTC available for allocation by each state (the “credit ceiling”) is limited by population. Each state is allocated credit based on a statutory formula indicated at section 42(h)(3). States may carry forward unused or returned credit derived from the credit ceiling for one year; if not used by then, credit goes into a national pool to be allocated to states as additional credit. State and local housing agencies allocate the state’s credit ceiling among low-income housing buildings whose owners have applied for the credit. Besides section 42 credits derived from the credit ceiling, States may also provide section 42 credits to owners of buildings based upon the percentage of certain building costs financed by tax-exempt bond proceeds. Credits provided under the tax-exempt bond “volume cap” do not reduce the credit available from the credit ceiling.

The credit allocated to a building is based on the cost of units placed in service as low-income units under certain minimum occupancy and maximum rent criteria. In general, a building must meet one of two thresholds to be eligible for the LIHTC: either 20 percent of units must be rent-restricted and occupied by tenants with incomes no higher than 50 percent of the Area Median Gross Income (“AMGI”), or 40 percent of units must be rent restricted and occupied by tenants with incomes no higher than 60 percent of AMGI. The term “rent-restricted” means that gross rent, including an allowance for utilities, cannot exceed 30 percent of the tenant’s imputed income limitation (i.e., 50 percent or 60 percent of AMGI). The rent and occupancy thresholds remain in effect for at least 15 years, and building owners are required to enter into agreements to maintain the low income character of the building for at least an additional 15 years.

The LIHTC reduces income tax liability dollar for dollar. It is taken annually for a term of ten years and is intended to yield a present value of either (1) 70 percent of the “qualified basis” for new construction or substantial rehabilitation expenditures that are not federally subsidized (i.e., financed with tax-exempt bonds or below-market federal loans), or (2) 30 percent of the qualified basis for the cost of acquiring certain existing projects or projects that are federally subsidized. The actual credit rates are adjusted monthly for projects placed in service after 1987 under procedures specified in section 42. Individuals can use the credit up to a deduction equivalent of \$25,000. This equals \$9,900 at the 39.6 percent maximum marginal tax rate. Individuals cannot use the credit against the alternative minimum tax. Corporations, other than S or personal service corporations, can use the credit against ordinary income tax. They cannot use the credit against the alternative minimum tax. These corporations can also deduct the losses from the project.

The qualified basis represents the product of the “applicable fraction” of the building and the “eligible basis” of the building. The applicable fraction is based on the number of low income units in the building as a percentage of the total number of units, or based on the floor space of low income units as a percentage of the total floor space of residential units in the building. The eligible basis is the adjusted basis attributable to acquisition, rehabilitation, or new construction costs (depending on the type of LIHTC involved). These costs include amounts chargeable to capital account incurred prior to the end of the first taxable year in which the qualified low income building is placed in service or, at the election of the taxpayer, the end of the succeeding taxable year. In the case of buildings located in designated Qualified Census Tracts or designated Difficult Development Areas, eligible basis can be increased up to 130 percent of what it would otherwise be. This means that the available credit also can be increased by up to 30 percent. For example, if the 70 percent credit is available, it effectively could be increased up to 91 percent.

Section 42 of the Code defines a Difficult Development Area as any area designated by the Secretary of HUD as an area that has high construction, land, and utility costs relative to the AMGI. All

designated Difficult Development Areas in MSAs/PMSAs may not contain more than 20 percent of the aggregate population of all MSAs/PMSAs, and all designated areas not in metropolitan areas may not contain more than 20 percent of the aggregate population of all non-metropolitan counties.

Under section 42(d)(5)(C) of the Code, a Qualified Census Tract is any census tract (or equivalent geographic area defined by the Bureau of the Census) in which at least 50 percent of households have an income less than 60 percent of the AMGI or, as amended by the Community Renewal Tax Relief Act of 2000, where the poverty rate is at least 25 percent. There is a limit on the number of Qualified Census Tracts in any Metropolitan Statistical Area ("MSA") or Primary Metropolitan Statistical Area ("PMSA") that may be designated to receive an increase in eligible basis: all of the designated census tracts within a given MSA/PMSA may not together contain more than 20 percent of the total population of the MSA/PMSA. For purposes of HUD designations of Qualified Census Tracts, all non-metropolitan areas in a state are treated as if they constituted a single metropolitan area.

### **Explanation of HUD Designation Methodology**

#### **A. Qualified Census Tracts**

In developing this list of LIHTC Qualified Census Tracts, HUD used 1990 Census data and the MSA/PMSA definitions established by the Office of Management and Budget ("OMB") in OMB Bulletin No. 99-04 on June 30, 1999. Beginning with the 1990 census, tract-level data are available for the entire country. Generally, in metropolitan areas these geographic divisions are called census tracts while in most non-metropolitan areas the equivalent nomenclature is Block Numbering Area ("BNA"). BNAs are treated as census tracts for the purposes of this Notice.

The LIHTC Qualified Census Tracts were determined as follows:

1. A census tract must have 50 percent of its households with incomes below 60 percent of the AMGI or have a poverty rate of 25 percent or more to be "eligible." HUD has defined 60 percent of AMGI as 120 percent of HUD's Very Low Income Limits (VLILs) 1990 Census benchmarks, which are based on 50 percent of area median family income. The 1990 income benchmarks are used because they

match the 1990 Census tract-level income data.

2. For each census tract, the percentage of households below the 60 percent income standard (the “income criterion”) was determined by (a) calculating the average household size of the census tract, (b) applying the income standard after adjusting it to match the average household size, and (c) calculating the number of households with incomes below the income standard.

3. For each census tract, the poverty rate was determined by dividing the population with incomes below poverty by the population for whom poverty status has been determined.

4. Qualified Census Tracts are those in which 50 percent or more of the households meet the income criterion or 25 percent or more of the population is in poverty such that the population of all census tracts that satisfy either one or both of these criteria does not exceed 20 percent of the total population of the respective area.

5. In areas where more than 20 percent of the population resides in eligible census tracts, one of two procedures is followed.

a. If more than 20 percent of the population resides in census tracts eligible by the income criterion, eligible census tracts are ordered from the highest percentage of eligible households to the lowest. Starting with the highest percentage, census tracts are included until the 20 percent limit is exceeded. If a census tract is excluded because it raises the percentage above 20 percent, then subsequent census tracts are considered to determine if one or more census tract(s) with smaller population(s) could be included without exceeding the 20 percent limit. No census tracts eligible solely by their poverty rates are designated in these areas.

b. If less than 20 percent of the population resides in census tracts eligible by the income criterion, census tracts eligible solely by their poverty rates are ordered from the highest poverty rate to the lowest. Starting with the highest poverty rate, census tracts are included until the 20 percent limit is exceeded. If a census tract is excluded because it raises the percentage above 20 percent, then subsequent census tracts are considered to determine if one or more census tract(s)

with smaller population(s) could be included without exceeding the 20 percent limit.

## **B. Difficult Development Areas**

In developing the list of Difficult Development Areas, HUD compared incomes with housing costs. HUD used 2000 Census population data and the MSA/PMSA definitions as published by the Office of Management and Budget in OMB Bulletin No. 99-04 on June 30, 1999, with the exceptions described in section D., below. The basis for these comparisons was the fiscal year (“FY”) 2001 HUD income limits for Very Low Income households and Fair Market Rents (“FMRs”) used for the section 8 Housing Assistance Payments program. The procedure used in making the Difficult Development Area calculations follows:

1. For each MSA/PMSA and each non-metropolitan county, a ratio was calculated. This calculation used the FY 2001 two-bedroom FMR and the FY 2001 four-person VLIL.
  - a. The numerator of the ratio was the area’s FY 2001 FMR. In general the FMR is based on the 40<sup>th</sup> percentile rent paid by recent movers for a two-bedroom apartment. In metropolitan areas granted a FMR based on the 50<sup>th</sup> percentile rent for purposes of improving the administration of HUD’s Housing Choice Voucher program (see 66 FR 162) the 40<sup>th</sup> percentile rent is used for nationwide consistency of comparisons.
  - b. The denominator of the ratio was the monthly LIHTC income-based rent limit calculated as 1/12 of 30 percent of 120 percent of the area’s VLIL (where 120 percent of the VLIL was rounded to the nearest \$50 and not allowed to exceed 80 percent of the AMGI in areas where the VLIL is adjusted upward from its 50 percent of AMGI base).
2. The ratios of the FMR to the LIHTC income-based rent limit were arrayed in descending order, separately, for MSAs/PMSAs and for non-metropolitan counties.
3. The Difficult Development Areas are those with the highest ratios cumulative to 20 percent of the 2000 population of all metropolitan areas and of all non-metropolitan counties.

### **C. Application of Population Caps to Difficult Development Area Determinations**

In identifying Difficult Development Areas and Qualified Census Tracts, HUD applied various caps, or limitations, as noted above. The cumulative population of metropolitan Difficult Development Areas cannot exceed 20 percent of the cumulative population of all metropolitan areas and the cumulative population of nonmetropolitan Difficult Development Areas cannot exceed 20 percent of the cumulative population of all nonmetropolitan counties.

In applying these caps, HUD established procedures to deal with how to treat small overruns of the caps. The remainder of this section explains the procedure. In general, HUD stops selecting areas when it is impossible to choose another area without exceeding the applicable cap. The only exceptions to this policy are when the next eligible excluded area contains either a large absolute population or a large percentage of the total population, or the next excluded area's ranking ratio as described above was identical (to four decimal places) to the last area selected, and its inclusion resulted in only a minor overrun of the cap. Thus for both the designated metropolitan and nonmetropolitan Difficult Development Areas there may be a minimal overrun of the cap. HUD believes the designation of these additional areas is consistent with the intent of the legislation. Some latitude is justifiable because it is impossible to determine whether the 20 percent cap has been exceeded, as long as the apparent excess is small, due to measurement error. Despite the care and effort involved in a decennial census, it is recognized by the Census Bureau, and all users of the data, that the population counts for a given area and for the entire country are not precise. The extent of the measurement error is unknown. Thus, there can be errors in both the numerator and denominator of the ratio of populations used in applying a 20 percent cap. In circumstances where a strict application of a 20 percent cap results in an anomalous situation, recognition of the unavoidable imprecision in the census data justifies accepting small variances above the 20 percent limit.

### **D. Exceptions to OMB Definitions of MSAs/PMSAs and Other Geographic Matters**

As stated in OMB Bulletin 99-04 defining metropolitan areas:

“OMB establishes and maintains the definitions of the [Metropolitan Areas] solely for statistical purposes ...OMB does not take into account or attempt to anticipate any nonstatistical uses that may be made of the definitions... We recognize that some legislation specifies the use of metropolitan areas for programmatic purposes, including allocating Federal funds.”

HUD makes exceptions to OMB definitions in calculating FMRs by deleting counties from metropolitan areas whose OMB definitions are determined by HUD to be larger than their housing market areas.

The following counties are assigned their own FMRs and VLILs and evaluated as if they were separate metropolitan areas for purposes of designating Difficult Development Areas.

*Metropolitan Area and Counties Deleted*

Chicago, IL: DeKalb, Grundy, and Kendall Counties.

Cincinnati-Hamilton, OH-KY-IN: Brown County, Ohio; Gallatin, Grant, and Pendleton Counties, Kentucky; and Ohio County, Indiana.

Dallas, TX: Henderson County.

Flagstaff, AZ-UT: Kane County, Utah.

New Orleans, LA: St. James Parish.

Washington, DC-MD-VA-WV: Clarke, Culpeper, King George, and Warren Counties, Virginia; and Berkeley and Jefferson Counties, West Virginia.

Affected MSAs/PMSAs are assigned the indicator “(part)” in the list of Metropolitan Difficult Development Areas. Any of the excluded counties designated as difficult development areas separately from their metropolitan areas are designated by the county name.

In the New England states (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont) OMB defines MSAs/PMSAs according to county subdivisions or Minor Civil Divisions (“MCDs”) rather than county boundaries. Thus, when a New England county is designated as a Nonmetropolitan Difficult Development Area, only that part of the county (the group of MCDs) not included in any MSA/PMSA is the Nonmetropolitan Difficult Development Area. Affected counties are

assigned the indicator “(part)” in the list of Nonmetropolitan Difficult Development Areas. Also in the New England States, census tracts may be cut by MSA/PMSA boundaries. Only those LIHTC projects located in the part of the tract in the listed MSA/PMSA or nonmetropolitan area may be allowed the increase in basis. Affected tracts are marked with an asterisk (\*) in the list of Qualified Census Tracts

For the convenience of readers of this notice, the geographic definitions of designated Metropolitan Difficult Development Areas and the MCDs included in Nonmetropolitan Difficult Development Areas in the New England states are included in the list of Difficult Development Areas.

Certain nonmetropolitan county equivalent areas in Alaska for which FMRs and VLILs are calculated and thus form the basis of Difficult Development Area designations are no longer recognized as geographic entities by the Census Bureau. Therefore, no 2000 Census population counts are produced for these areas. HUD estimates the 2000 population of these areas as follows:

1. The 2000 Population of Denali Borough (1,893) was allocated entirely to the Yukon-Koyukuk Census Area. The part of Denali Borough created from the Southeast Fairbanks Census Area was deemed uninhabited after examination of Census Block data for the area of Denali Borough formerly in the Southeast Fairbanks Census Area.
2. The population of Yakutat City and Borough (808) was allocated to the former Skagway-Yakutat-Angoon Census Area (680) and the Valdez-Cordova Census Area (128). The populations of Yakutat City and Borough Census Blocks located east of 141° longitude were allocated to the Skagway-Yakutat-Angoon Census Area. The populations of Yakutat City and Borough Census Blocks located west of 141° longitude were allocated to the Valdez-Cordova Census Area.

### **Future Designations**

Difficult Development Areas are designated annually as updated income and FMR data become available. Qualified Census Tracts will be redesignated next year when data from the 2000 Census become available.

**Effective Date**

The list of Difficult Development Areas and the list of Qualified Census Tracts is effective for allocations of credit made after December 31, 2001. In the case of a building described in section 42(h)(4)(B) of the Code, the list is effective if the bonds are issued and the building is placed in service after December 31, 2001.

**Interpretive Examples for Effective Date**

For the convenience of readers of this Notice, interpretive examples are provided below to illustrate the consequences of the effective date in areas that gain or lose Difficult Development Area status with respect to projects described in section 42(h)(4)(B) of the Code. The examples are equally applicable to Qualified Census Tract designations.

**(Case A)** Project “A” is located in a newly-designated 2002 Difficult Development Area. Bonds are issued for Project “A” on November 1, 2001, and Project “A” is placed in service March 1, 2002. Project “A” IS NOT eligible for the increase in basis otherwise accorded a project in this location because the bonds were issued BEFORE January 1, 2002.

**(Case B)** Project “B” is located in a newly-designated 2002 Difficult Development Area. Project “B” is placed in service November 15, 2001. The bonds which will support the permanent financing of Project “B” are issued January 15, 2002. Project “B” IS NOT eligible for the increase in basis otherwise accorded a project in this location because the project was placed in service BEFORE January 1, 2002.

**(Case C)** Project “C” is located in an area which is a Difficult Development Area in 2001, but IS NOT a Difficult Development Area in 2002. Bonds are issued for Project “C” on October 30, 2001, but Project “C” is not placed in service until March 30, 2002. Project “C” is eligible for the increase in basis available to projects located in 2001 Difficult Development Areas because the first of the two events necessary for triggering the effective date for buildings described in section 42(h)(4)(B) of the Code (the two events being bonds issued and buildings placed in service) took place on October 30, 2001, a time when project “C” was located in a Difficult Development Area.

## **Other Matters**

### **Environmental Impact**

In accordance with 40 CFR 1508.4 of the CEQ regulations and 24 CFR 50.19(c)(6) of the HUD regulations, the policies and procedures contained in this notice provide for the establishment of fiscal requirements or procedures which do not constitute a development decision that affects the physical condition of specific project areas or building sites and therefore, are categorically excluded from the requirements of the National Environmental Policy Act, except for extraordinary circumstances, and no FONSI is required.

### **Regulatory Flexibility Act**

In accordance with 5 U.S.C. section 605(b) (the Regulatory Flexibility Act), the undersigned hereby certifies that this notice does not have a significant economic impact on a substantial number of small entities. The notice involves the designation of “Difficult Development Areas” and “Qualified Census Tracts” as required by section 42 of the Code, as amended, for use by political subdivisions of the States in allocating the Low-Income Housing Tax Credit. This notice places no new requirements on the States, their political subdivisions, or the applicants for the credit. This notice also details the technical methodology used in making such designations.

### **Executive Order 12612, Federalism**

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, Federalism, has determined that the policies contained in this notice will not have any substantial direct effects on States or their political subdivisions, or the relationship between the Federal government and the States, or on the distribution of power and responsibilities among the various levels of government. As a result, the notice is not subject to review under the order. The notice merely designates “Difficult Development Areas” and “Qualified Census Tracts” as required under section 42 of the Internal Revenue Code, as amended, for the use by political subdivisions of the States in allocating the Low-Income Housing Tax Credit. The notice also details the technical methodology used in making such designations.

Dated: \_\_\_\_\_

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Mel Martinez  
Secretary